This draft is provided for discussion purposes only to determine what topics a possible proposed rule might address. This discussion draft is under no circumstances to be used to determine a tax liability and/or eligibility for tax exemptions.

DRAFT -- RULES ON INTANGIBLE PERSONAL PROPERTY

WAC 458-XX-001 Intangible personal property exemption--Introduction.

(1) **Goal of these rules relative to exemption of intangible personal property.** Although the Washington constitution allows for property taxation of all property subject to ownership, "whether tangible or intangible," the legislature has exempted some intangible property from property taxation for many years. In 1997, the legislature expanded the exemption for intangible personal property and provided examples of exempt property. The following rules are intended to provide additional clarification of the statute and provide guidelines to be used by assessing officials in determining the taxable value of property. The goal is to ensure, in as fair and equitable a manner as possible, that all taxable value is assessed and all non-taxable value is not assessed.

(2) **Application of these rules.** These rules primarily implement RCW 84.36.070, which establishes a property tax exemption for intangible personal property, but also apply to chapters 84.12 and 84.16 RCW, the statutory chapters dealing with the assessment of public utility, and private car company property, respectively, by the state, and to chapter 84.40 RCW, which deals with assessment of property at the county level.

WAC 458-XX-005 Exempt intangible property distinguished from other intangibles.

Distinction between property, and characteristics or attributes of property. The statute (RCW 84.36.070) draws a distinction between intangible personal property and the characteristics or attributes of property, both real and personal. Intangible personal property is exempt from property taxation. However, some characteristics or attributes of property, even though intangible, may be considered in establishing the taxable value of tangible property.

(1) **What intangible personal property is exempt?** The listings of examples of intangible personal property contained in RCW 84.36.070(2) must be consulted, but those listings can be summarized as follows:

(a) Financial intangible property, such as moneys, credits, and publicly issued bonds and warrants, and the bonds, stocks, or shares of private corporations;

(b) Private personal service contracts and athletic or sports franchises, or sports agreements that do not pertain to the use or possession or any interest in tangible personal or real property; and

(c) Miscellaneous types of intangible personal property, such as trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses (that is, licenses wholly between private parties rather than licenses granted by a government agency that affect the use of the property, *see* subsection (3)(b) below), permits (privately granted), core deposits of financial institutions, noncompete agreements, customer lists, patient lists, favorable contracts, favorable financing agreements, reputation, exceptional management, prestige, good name, integrity of a business, and other similar types of intangible personal property.

(2) **Identifying exempt intangible property.** Intangible property is only exempt if it is personal property capable of being separately owned, used, transferred, or held separately from other property. Intangible personal property should not be identified or characterized using residual accounting methods, or other indirect means such as isolating "excess earnings," from a total business valuation. The market value of intangible personal property should be determined independently of residual techniques.

(3) **What intangible characteristics, attributes or other factors affect value and are to be considered?** Nonproperty intangible characteristics or attributes are elements or components of value associated with an asset. These characteristics or attributes are "intangible" but they are not "property" and therefore are not tax exempt intangible personal property. They are contingent and dependent upon other property and can not be owned, used, transferred, or held separately. To the extent that these characteristics, attributes or other factors contribute to, or affect, the value of property, they must be appropriately considered when determining taxable value. They include the following types:

(a) Zoning, location, view, geographic features, easements, covenants, proximity to raw materials, condition of surrounding property, proximity to markets, or the availability of a skilled work force;

(b) Grants of licenses, permits, and franchises by a government agency that affect the use of the property being valued; and

(c) Other characteristics of property, such as scarcity, uniqueness, adaptability, or utility as an integrated unit or going concern.

WAC 458-XX-010 Valuation principles.

(1) **What is meant by "true and fair value"?** One hundred percent of true and fair value is the standard used by assessing officials for valuing both taxable property and exempt property. True and fair value is the same as market value or fair market value. It is the amount of money a buyer of property willing but not obligated to buy would pay a seller of property willing but not obligated to sell, taking into consideration all uses to which the property is adapted and might in reason be applied. This term incorporates all the rights and benefits, present and future, associated with the ownership of property.

(2) **Approaches to value.** All three traditional approaches to value may be used by assessing officials. These approaches are cost, including the actual cost new or historical cost less depreciation, the cost of reproduction new less depreciation and plus appreciation; income, including the past, present, and prospective gross and net earnings of the whole system as a unit; and market, including the par value, actual value and market value of the company's outstanding stocks and bonds during one or more preceding years.

(3) **Generally accepted appraisal practices.** "Generally accepted appraisal practices" are the appropriate application in the valuation of real and tangible and intangible personal property, of accepted standards of professional appraisal practice as described in the Uniform Standards of Professional Appraisal Practice issued by the Appraisal Standards Board of the

Appraisal Foundation or the accepted standards of other nationally recognized professional appraisal organizations.

WAC 458-XX-015 Appraisal practices relating to valuing intangible personal property.

(1) **Unit valuation.** When valuing companies with operating property in more than one county or more than one state, the Department determines what property is subject to assessment and taxation by the state, and determines the market value of that property. The market value is not a summation of fractional appraisals but is the value of a company as an operating unit. The unitary approach is used in the valuation of properties which derive their value from interdependent assets working together. The Department is statutorily authorized to take into consideration "the value of the whole system as a unit." (RCW 84.12.300; *see also* RCW 84.16.050.) Property valued as a unit may have augmented or enhanced value above what the value would be using the summation method of valuation, which values individual assets and then sums the total.

(2) **Situs.** Property taxes may only be levied upon property having situs in this state, in other words, located in this state. Once the taxable value, meaning the total value of a company's operating property in this state less the exempt value, has been determined by the assessing official, the taxable value is apportioned as required by law.

(3) **Valuation of exempt intangible personal property.** In determining the taxable value of a company as an operating unit, and taking into consideration the exemption of intangible personal property, assessing officials may use one of two methods, as appropriate. The true and fair value of the exempt property is deducted from the whole system value to arrive at taxable value, or the appraisal model used to arrive at taxable value has built-in assumptions that approximate the exclusion of exempt property value from the model. These two methods are explained in more detail as follows.

(a) The first method is a two step process that involves valuing the entire company operation (the unit) as the first step, using any or a combination of the three traditional approaches to value. Then the exempt property is separately identified, valued, and deducted from the unit value. In valuing the exempt property, assessing officials use generally accepted appraisal practices, including sales of similar intangible personal property, capitalization rates obtained through those sales, or by identifying cash flows attributable to each intangible property asset. The exempt property may be property not located in this state, or it may be property that is statutorily exempt, such as intangible personal property. When using this method, the value resulting from deducting the exempt value from the entire company value, is the taxable value.

(b) The second method involves an appraisal process using an appraisal model that intrinsically approximates the exclusion of exempt intangible value. This process assumes the existence of intangible personal property in the overall value of the company being valued, but does not specifically identify or value individual intangible personal property assets. One example of such a model is one that eliminates all or some of a company's estimates of real growth. When assessing officials use this method, they must also make a reasonable effort to compare the valuation result reached with the valuation result reached by the method described in subsection (3)(a) above. A showing of reasonable effort by the assessing official would, at a minimum, include proof that the official has requested input by the taxpayer regarding whether the taxpayer believes this method has properly excluded exempt property.

(4) **Unit value at the county level.** When a business operates in more than one location within a county, but is physically, economically, and functionally integrated, it may also be valued by the assessor as a unit.

WAC 458-XX-020 Valuation of particular assets.

(1) **Computer software.** Computer software is generally exempt from property taxation, but that exemption is specifically dealt with in RCW 84.36.600 (exemption), RCW 84.04.150 (definitions), and WAC 458-12-251. RCW 84.36.070 and these rules do not apply to computer software, and nothing in that statute nor these rules may be construed to amend or modify that existing statute and the rule dealing with the property tax treatment of computer software.

(2) **Tax credits?**

(3) **Other?**